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THE CITY OF SAN DIEGO

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**OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT**

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Date Issued: October 24, 2007

IBA Report Number: 07-103

City Council Docket Date: October 22, 2007

Item Number: 200

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## City Reserve Policy

### OVERVIEW

Item 200 requests City Council approval of the City Reserve Policy and the establishment of the Appropriated Reserves in the General Fund in the amount of \$7.0 million for Fiscal Year 2008.

The Reserve Policy has been reviewed and discussed by the Budget and Finance Committee on three occasions. This report is provided to describe the most recent revisions made to the policy in response to committee recommendations. The revised Reserve Policy is reflected in the October 12, 2007 memorandum from Chief Operating Officer Jay Goldstone.

### FISCAL/POLICY DISCUSSION

In Report No. 07-90, dated September 20, 2007, the IBA recommended to the Budget and Finance Committee that the:

- 1) City Attorney provide a legal opinion related to the applicability and interpretation of Charter Section 91;
- 2) Appropriation Ordinance be revised to ensure terminology related to reserves is consistent with the proposed policy;
- 3) Definition of Dedicated Reserves be clarified; and
- 4) Appropriated Reserves be funded concurrently with the adoption of the policy to allow for unanticipated expenses during the current fiscal year

At its meeting on September 26, 2007, the Budget and Finance Committee voted 5 to 0 to recommend the proposed Reserve Policy to the full City Council with the following changes/additions:



**Office of Independent Budget Analyst**

202 C Street, MS 3A • San Diego, CA 92101  
Tel (619) 236-6555 Fax (619) 236-6556

- 1) that the second sentence on page 5, in the section on Dedicated Reserves, which reads as follows be deleted: "These funds shall automatically carry over to future budget years and not require any further appropriation of funds by the City Council as long as the funds are used for the pre-identified purpose(s)." The Chief Financial Officer is requested to suggest alternative language for the Council's consideration when it takes up the proposed Reserve Policy; and
- 2) that all recommendations by the Independent Budget Analyst be included in the policy.

#### Charter Section 91 Legal Opinion

On September 27, 2007, the Office of the City Attorney provided a legal opinion on Charter Section 91 (attached), which, in part, states:

*"It is concluded herein that charter section 91 establishes a mandatory duty for Council to establish a General Reserve Fund that can only be drawn upon in the event of a public emergency after an affirmative 2/3s vote of the Council. To the extent that the City has cash on hand to cover four months of the fiscal year prior to the receipt of taxes, the charter provision would be satisfied by funding the General Reserve Fund at a fiscally prudent level of 5 to 15% of general fund operating expenditures."*

The revised Reserve Policy, as reflected in the October 12, 2007 memorandum from Chief Operating Officer Jay Goldstone, establishes **Emergency Reserves**, which would only be used for qualifying emergencies as declared by the Mayor and/or City Council and ultimately approved by the City Council. Approval for expenditures from the Emergency Reserves would require an amendment to the annual Appropriation Ordinance (via ordinance) approved by at least two-thirds of the City Council. The amount of the Emergency Reserves is proposed to reach a minimum of 8% of the General Fund by Fiscal Year 2012, increasing by 0.5% increments from 6.0% at the end of the current fiscal year (Fiscal Year 2008).

This reserve amount is consistent with the Mayor's Five Year Financial Outlook, and as currently proposed, satisfies the requirements of Charter Section 91, as described by the Office of the City Attorney.

#### Appropriated Reserves

The City Council is being asked to appropriate \$7.0 million from the existing Unallocated Reserves to create the **Appropriated Reserves**. The IBA previously recommended the establishment of Appropriated Reserves in the amount of \$10 million, in conjunction with the adoption of the Reserve Policy.

Actions taken already this fiscal year to fund unanticipated expenses from the reserve include:

- \$1,980,000 to fund the settlement agreement with the Chargers Football Club
- \$688,000 for contract amendment for Macias, Gini & O'Connell, LLP

- \$370,000 for contract with Hawkins, Delafield & Wood

Including these amounts with the \$7.0 million Appropriated Reserves results in approximately \$10 million for unanticipated expenses for the full fiscal year. Future requirements for unanticipated expenses that arise during the course of the year would come from the Appropriated Reserves, unless needs arise from emergency circumstances. The expenditure of funds from the Appropriated Reserves would require the adoption of a resolution with a majority vote of the City Council.

#### Dedicated Reserves

The revised Reserve Policy reflects changes to the **Dedicated Reserves** definition specifying these are for non-capital projects or activities that take multiple years to fund, and that the City Council may review the Dedicated Reserves annually during the budget process. In previous versions, these reserves were to automatically carryover to future fiscal years without Council review.

#### Appropriation Ordinance

The IBA had recommended that the Appropriation Ordinance (AO) should be reviewed to determine if amendments may be needed to include new terms introduced with the Reserve Policy, and to ensure that any excess revenues received would flow to the appropriate reserve.

It is not imperative that changes to the AO be made at the time the Reserve Policy is adopted. Any needed changes could be presented as part of the Mid-Year Budget Adjustments in early 2009, or as part of the Fiscal Year 2009 Appropriation Ordinance, following the budget development process.

## CONCLUSION

Recent revisions to the Reserve Policy incorporated the recommendations made by the IBA and the Budget and Finance Committee. It is possible that the Appropriation Ordinance may need to be amended, or revised, in the future, to ensure consistent use of new terms which have been introduced with the Reserve Policy. The IBA recommends that the City Council adopt the Reserve Policy, and create the Appropriated Reserves in the amount of \$7.0 million for Fiscal Year 2008.



Elaine DuVal  
Fiscal & Policy Analyst



APPROVED: Andrea Tevlin  
Independent Budget Analyst

Attachment: City Attorney Legal Opinion – Charter Section 91

ATTORNEY TO CLIENT  
CORRESPONDENCE

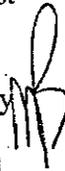
Office of  
The City Attorney  
City of San Diego

MEMORANDUM  
MS 59

(619) 236-6220

**DATE:** September 27, 2007

**TO:** Andrea Tevlin, Independent Budget Analyst  
Greg Levin, Comptroller

**FROM:** Mark D. Blake, Chief Deputy City Attorney 

**SUBJECT:** Funding Requirement of Charter section 91

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At the July 11, 2007 and September 26, 2007 meetings of the Budget and Finance Committee the Independent Budget Analyst asked the Chief Financial Officer for an interpretation of the funding requirements of charter section 91. This question has been sent the office of the City Attorney for further review. The City Attorney has previously written opinions on charter section 91, and those opinions are attached hereto as Exhibit A. It is concluded herein that charter section 91 establishes a mandatory duty for Council to establish a General Reserve Fund that can only be drawn upon in the event of a public emergency after an affirmative 2/3s vote of the Council. Charter section 91 is permissive with respect to the funding level of the General Reserve Fund. To the extent that the City has cash on hand to cover four months of the fiscal year prior to the receipt of taxes, the charter provision would be satisfied by funding the General Reserve Fund at a fiscally prudent level of 5 to 15% of general fund operating expenditures.

Charter section 91 falls under the caption "General Reserve Fund" and reads as follows:

The Council shall create and maintain a permanent revolving fund, to be known as the General Reserve Fund, for the purpose of keeping the payment of the running expenses of the City on a cash basis. Said fund shall be maintained in an amount sufficient to meet all legal demands against the treasury for the first four months or other necessary period of each fiscal year prior to the collection of taxes. This fund may be

expended only in the event of a public emergency when it shall be determined by the affirmative vote of at least two-thirds of the members elected to the Council that such expenditures are necessary in order to insure the safety and lives and property of the City or its inhabitants.”

The scope of charter section 91 is unclear, including whether it requires the establishment of a general reserve fund covering all funds of the City or one that simply covers the City’s General Fund. The language indicates that it must be established “for the purpose of keeping the payment of the running expenses of the City on a cash basis” . . . “sufficient to meet *all* legal demands against the treasury. . . .” This language is sufficiently broad to encompass all funds of the City, including the City’s enterprise funds. The better reading of this section is that charter section 91 is only intended to apply to the City’s General Fund. The City’s enterprise funds (namely water and wastewater) are intended to be self-liquidating operation supported by fees and charges of the respective enterprise. Such fees and charges should be sufficient to provide for the operation and maintenance of such enterprises, including any necessary reserves therefore, without any expectation of emergency funding from the City’s general fund’s reserve. Accordingly, while the matter is not free from doubt, it is the view of the City Attorney that charter section 91 only requires the establishment of a General Reserve Fund for City operating expenses.

As discussed in the earlier City Attorney opinions, charter section 91 was originally authorized when the City charter was adopted in 1931. Charter section 91 was amended in 1963 to liberalize some of its provisions. A reading of the 1963 amendments to charter section 91 indicates that the drafters intended to liberalize the replenishment requirements of the General Reserve Fund, and eliminated the requirement that Council replenish the fund in the same fiscal year that the fund was drawn upon. The 1963 amendments to the charter also contained other amendments to section 69, 71, 77, 92 and 93 of the charter. This memorandum will limit its inquiry simply to an analysis of the language of charter section 91.

As written, Charter section 91 utilizes the mandatory statutory language “shall” in several of its provisions. Whenever the word “shall” appears in a statute it is generally understood that such language connotes a command and leaves little room for discretion. *People v. Municipal Court of Oxnard-Port Hueneme Judicial Dist. Ventura County* (1956) 145 Cal.App.2d 767. The test is whether to construe such words as directory would defeat the purpose of the enactment. *Id.* As such, the following mandatory directives are given to the Council: (i) the Council “*shall* create and maintain a permanent revolving fund to be known as the General Reserve Fund . . .” (ii) , such fund “*shall* be maintained in an amount sufficient to meet all legal demands against the treasury for the first four months or other necessary period of each fiscal year prior to the collection of taxes” . . . , and (iii) monies can only be expended from the fund “only in the event of a public emergency when it *shall* be determined by the affirmative vote of at least two-thirds of the members elected to the Council that such expenditures are necessary to insure the safety and lives and property of the City or its inhabitants.”

Charter section 91 clearly commands that the Council establish a General Reserve Fund and that, once established, such General Reserve Fund must be maintained and only drawn upon in the event of a public emergency. These are not simply directory but rather impose real duties upon the Council. To read the provisions of charter section 91 as merely directory would defeat the express purpose of ensuring that the City has sufficient cash on hand to meet unexpected contingencies. No attempt will be made to define the contours of the term "public emergency." Suffice it to say, that such term connotes an event more significant than year-in-year-out budgetary shortfalls or expenditure overages.

What is less clear is the charter section 91 funding requirement. The language of Charter section 91 provides alternative funding methodologies. The General Reserve Fund may be funded at a level sufficient to meet all legal demands against the City for "the first four months" or "other necessary period" of each fiscal year. In so doing the drafters of charter section 91 confounded and confused what appears to be competing aims of this provision. It appears that the drafters were attempting to accomplish two purposes. At one level, the drafters evidence a desire to ensure that the City has available revenues to meet "all legal demands against the City . . . prior to the collection of taxes." But this is a cash flow concept that may be satisfied by the availability of cash on hand, though the issuance of its tax and revenue anticipation notes under charter section 92 or perhaps interfund borrowings under the authority of charter section 93.

A competing aim of charter section 91 is to create an emergency reserve that can only be drawn upon in the event of a public emergency determined by a two-thirds affirmative vote of the Council.

In City Attorney Opinion 84-3, dated February 28, 1984, this office concluded that to the extent that the legislative body approves the issuance of short term notes (under charter section 92) or authorizes temporary loans to any tax supported funds from any other funds of in the treasury pursuant to section 93, the General Reserve Fund funding requirement can be reduced. In other words, the cash flow metric of charter section 91 can be avoided by virtue of looking at whether the City has cash on hand constituting the first four months of each fiscal year.

However we part company with that opinion to the extent that it suggests that charter section 91 does not require substantial funding. It does. The charter provision evidences the legislative intent that the City Council establishes a reserve that carries over from fiscal year to fiscal year that can only be drawn upon in the occurrence of a public emergency, subject to a two-thirds affirmative vote of the Council. This reserve must be funded if not at the "first four month" level then at a level for such "other necessary period." Regrettably the charter does not provide guidance for the alternate funding level.

Given that the Council has an obligation under Charter section 91 to establish a General Reserve Fund, it has to fund it at a prudent and fiscally sound level. This office suggests that the guidance provided by the Government Finance Officer's Association be

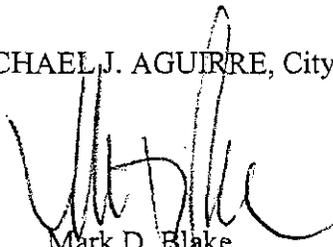
utilized, which suggests funding levels of between 5% and 15% of operating expenditures level. See the Report of the Mayor, Proposed Reserve Policy, dated September 26, 2007.

Therefore, the City Attorney concludes that the Council must discharge its legal obligations under Charter section 91 by establishing and funding a General Reserve Fund in an amount between 5% and 15% of operating expenditures. This amount would be *fiscally prudent and would satisfy the spirit of charter section 91*. With that said, the City Attorney also concludes that a funding the general reserve at this level may need to be increased should the City not at any time have cash on hand constituting four months of any fiscal year.

Please do not hesitate to contact me if you have any additional questions.

MICHAEL J. AGUIRRE, City Attorney

By



Mark D. Blake

Chief Deputy City Attorney

MDB:jdf

CC: Honorable Mayor  
City Councilmembers  
Jay Goldstone, Chief Financial Officer

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COMMITTEE ACTION SHEET

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COUNCIL DOCKET OF _____				
<input type="checkbox"/> Supplemental	<input type="checkbox"/> Adoption	<input type="checkbox"/> Consent	<input type="checkbox"/> Unanimous Consent	Rules Committee Consultant Review

R -

O -

Proposed Reserve Policy
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Reviewed     Initiated    By Budget    On 9/26/07    Item No. 2

RECOMMENDATION TO:

<p>Recommend the proposed Reserve Policy to the full Council with the following changes/additions: 1) That the second sentence on page 5, in the section on Dedicated Reserves, which reads as follows be deleted: "These funds shall automatically carry over to future budget years and not require any further appropriation of funds by the City Council as long as the funds are used for the pre-identified purpose(s)." The Chief Financial Officer is requested to suggest alternative language for the Council's consideration when it takes up the proposed Reserve Policy; and 2) that all recommendations by the Independent Budget Analyst be included in the policy.</p>
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VOTED YEA: Atkins, Faulconer, Peters, Frye, Madaffer

VOTED NAY:

NOT PRESENT:

CITY CLERK: Please reference the following reports on the City Council Docket:

REPORT TO THE CITY COUNCIL NO.

COUNCIL COMMITTEE CONSULTANT ANALYSIS NO.

OTHER:

Independent Budget Analyst's Report No. 07-90; Chief Financial Officer's September 26, 2007, memorandum
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COUNCIL COMMITTEE CONSULTANT 



000193

## THE CITY OF SAN DIEGO

## OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

Date Issued: September 20, 2007

IBA Report Number: 07-90

Budget &amp; Finance Committee Agenda Date: September 26, 2007

Item Number: 2

Subject: Proposed Reserve Policy

**OVERVIEW**

On July 11, 2007 and July 25, 2007, the Chief Financial Officer presented the proposed City Reserve Policy to the Budget and Finance Committee. The Committee requested that the IBA review the proposed policy and provide recommendations, and the IBA issued Report No. 07-75, dated July 20, 2007, with specific recommendations. The IBA and CFO have discussed various issues related to the proposed reserve policy, and many improvements have been incorporated in the revised version now being presented. A few critical issues remain outstanding, including interpretation of Charter Section 91, funding of the Appropriated Reserve, and the time frame for adoption of the reserve policy.

**FISCAL/POLICY DISCUSSION**Charter Section 91

The IBA previously noted that earlier versions of the reserve policy did not address the requirements of Charter Section 91. Revisions have since been made to include an explanation that the City Treasurer's Investment Policy together with annual short-term borrowings using Tax and Revenue Anticipation Notes satisfy the Charter requirement to provide sufficient cash to meet all legal demands, and a two-thirds (instead of majority) vote of the Council is now required to authorize expenditures for emergency purposes from the reserve. Questions remain if the amount in the reserve is considered adequate under the formula provided in the Charter, or if it is

Charter Section 91, entitled "*General Reserve Fund*", states the following: The Council shall create and maintain a permanent revolving fund, to be known as the General Reserve Fund, for the purpose of keeping the payment of the running expenses of the City on a cash basis. Said fund shall be maintained in an amount sufficient to meet all legal demands against the treasury for the first four months or other necessary period of each fiscal year prior to the collection of taxes. This fund may be expended only in the event of a public emergency when it shall be determined by the affirmative vote of at least two-thirds of the members elected to the Council that such expenditures are necessary in order to insure the safety and lives and property of the City or its inhabitants.



Office of Independent Budget Analyst

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appropriate to consider the City's pooled investments in order to satisfy this need. Based on the current Fiscal Year 2008 General Fund budget of \$1.1 billion, four months, or one-third of the annual amount, would require a cash reserve of \$370 million. The target reserve level of 6% of the General Fund budget would result in a reserve of approximately \$66 million. The IBA has requested that the City Attorney's Office opine on this outstanding issue.

#### Appropriated Reserve

As currently written, upon adoption of the policy, the Unallocated Reserve would become the Emergency Reserve. It is intended that an Appropriated Reserve would be funded through the annual budget process to provide for unanticipated expenses during the fiscal year, however, funding for this was not included in the Fiscal Year 2008 Budget. Specific Council action would be needed to authorize the initial funding of the Appropriated Reserve.

Without a funded Appropriated Reserve, the Council is likely to be placed in a position throughout this fiscal year of waiving the newly adopted reserve policy to allow the use of the Emergency Reserve for inevitable, non-emergency purposes, as well as mid-year and year-end budget adjustments.

The last accounting received of the General Fund reserve for Fiscal Year 2007 showed approximately \$20 million was expended from the reserve for legal, audit, and investigative services, as well as mid-year and year-end budget adjustments.

While we are not advocating for mid-year expenditures and the use of reserves on a regular basis, it is a practical reality that budget adjustments will be needed to ensure a balanced budget, and additional legal costs may be unavoidable. Unused funds within the Appropriated Reserve will be directed to the Emergency Reserve at year-end. However, it would prove more difficult to access the Emergency Reserve should additional amounts be needed.

Based on this, the IBA poses the following options:

- Adopt the reserve policy to be effective only upon Council action to transfer \$10 million from the current Unallocated Reserve to create an Appropriated Reserve for unanticipated expenses during the current fiscal year. Unused funds within the Appropriated Reserve will be directed to the Emergency Reserve at year-end.
- Implement the reserve policy effective July 1, 2008 once funding has been adequately provided for an Appropriated Reserve in next year's budget.

Changes Recently Incorporated

At the request of the IBA, additional improvements have been incorporated into the revised version of the policy, including:

- Status reports will be provided with each request to use reserve funds
- Quarterly financial reports will include a status of all reserve funds, including current balances.

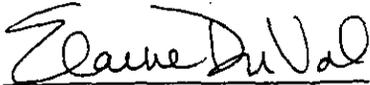
**CONCLUSION**

The IBA recognizes the importance of enacting a comprehensive reserve policy in order to establish sound formal fiscal reserve policies, build adequate reserves, and to guide the City toward meeting its short-term and long-term obligations and to ensure the City maintains the highest credit rating possible. Throughout this process, the CFO has incorporated many suggestions offered by the IBA.

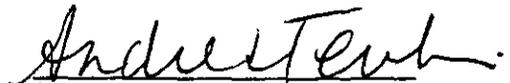
The IBA recommends the following:

- 1) A legal opinion from the City Attorney is requested in order to resolve outstanding issues related to the applicability and interpretation of Charter Section 91. Further changes may be needed to the policy, once the opinion has been issued.
- 2) As previously noted, the Fiscal Year 2008 Appropriation Ordinance includes multiple references to Unallocated Reserve(s) or Unappropriated Reserve(s). Upon the adoption of the proposed reserve policy, it is recommended that the Appropriation Ordinance be revised to ensure terminology is consistent.
- 3) Upon further review of the proposed policy, it is unclear how the recommendation for a Dedicated Reserve differs from other appropriated reserves or encumbrances, when referring to specific projects or purchases. We recommend elimination of this category, unless its need can be justified.
- 4) Adopt the reserve policy to be effective only upon Council action to transfer \$10 million from the current Unallocated Reserve to create an Appropriated Reserve for unanticipated expenses during the current fiscal year.

Alternatively, the Council could consider the adoption of the reserve policy to be effective July 1, 2008, in conjunction with an adequately funded Appropriated Reserve.



Elaine DuVal  
Fiscal & Policy Analyst



APPROVED: Andrea Tevlin  
Independent Budget Analyst

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THE CITY OF SAN DIEGO  
MAYOR JERRY SANDERS

M E M O R A N D U M

DATE: September 26, 2007  
TO: Budget and Finance Committee  
FROM: Jay M. Goldstone, Chief Operating Officer  
SUBJECT: Proposed Reserve Policy

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Attached for your consideration is the recommended Reserve Policy. I wish to make it clear that while a specific level of funding for the General Fund Appropriated Reserve is not called for in the Policy, it will be the Mayor's recommendation in the Request for Council Action (1472) that will bring this item forward to the full Council for action to fund the Appropriated Reserve at a level of \$10 million for fiscal year 2008, less actions already taken by the City Council.

Jay M. Goldstone  
Chief Operating Officer

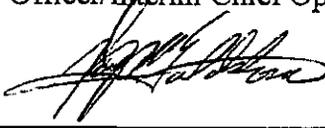
Cc: Honorable Mayor Jerry Sanders  
Honorable Council President Peters and Councilmembers  
Mary Lewis, Financial Management Director  
Andrea Tevlin, Independent Budget Analyst  
Greg Levin, City Comptroller



THE CITY OF SAN DIEGO  
MAYOR JERRY SANDERS

## MEMORANDUM

DATE : September 26, 2007  
TO: Budget and Finance Committee  
FROM: Jay M. Goldstone, Chief Financial Officer/Interim Chief Operating Officer  
SUBJECT: City Reserve Policy



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### INTRODUCTION

The following represents a comprehensive reserve policy for the major funds of the City of San Diego and recommends a phased approach in setting reserve levels.

One of the key components of a financially stable organization is the establishment and maintenance of appropriate reserves and the adoption of a prudent reserve policy. While the City of San Diego has a reserve objective, it does not have a clearly delineated policy to govern decision-making and fiscal actions by its officials. This is essential, especially as the City works to restore its financial standing in the bond community.

### OBJECTIVES

- A. Establish sound formal fiscal reserve policies. These policies will be the foundation for ensuring that strong fiscal management and policies guide future City decisions.
- B. Build adequate reserves. This action will provide the City with resources to help stabilize the organization and will position it during economic downturns or large-scale emergencies. In addition, it is critical to minimize the potential for reactive decision-making which often leads to poor choices and unpleasant consequences.
- C. Guide the City toward meeting its short-term and long-term obligations and to ensure that the City maintains the highest credit rating possible.

### BACKGROUND

City Charter Section 91 stipulates that the City maintain a "General Reserve Fund" to meet the cash obligations of the City for four months or prior to the collection of taxes. The fund

may only be expended in an emergency, requiring a two-thirds vote by the City Council. This Charter requirement is met through the City Treasurer's Investment Policy that is approved by City Council.

The Investment Policy stipulates that the City's pooled investment fund shall be comprised of a core and liquidity portfolio. The liquidity portfolio is designed to ensure that the projected expenditures and demands for cash can be met over a six month period. Cash flows are calculated and monitored to determine the required amount of operating cash. The liquidity portfolio established by the Investment Policy meets and exceeds the City Charter Section 91 which requires the City to have an available source of cash in order to meet the legal demands against the City for the first four months of each fiscal year prior to the collection of taxes. The City has historically borrowed funds (Tax Revenue Anticipation Notes) at the beginning of each fiscal year to ensure that there is sufficient cash prior to the receipt of property tax.

On October 15, 2002, the City Council adopted the General Fund Reserve Policy which established and maintained a General Fund Reserve level that is sufficient to address unforeseen contingencies such as natural disasters, catastrophic occurrences, or excessive liabilities or judgments against the City. The Reserve Policy specified that the General Fund Reserve should be set at a minimum of 3% of annual General Fund revenues with a goal of establishing the General Fund Reserve at 5% of annual General Fund revenues by fiscal year 2014. Considering the recommendations of the rating agencies (Standard and Poor's, Moody's, and Fitch Ratings) and the need to demonstrate the ability to weather fluctuations in revenue and unforeseen expenditure pressures, reserves greater than 5% need to be established through a defined policy.

The reserve policy recommends that the City establish and maintain appropriate reserves for the City's major funds. Adequate reserve levels would allow the City to withstand short-term revenue and expenditure swings which can result in short-term decisions with negative long-term implications, mitigate the impact of economic downturns that result in reduced municipal revenues from the State, respond to the budgetary affects of natural disasters or other catastrophic events, excessive liabilities or legal judgments against the City, reduce the amount of Tax Revenue Anticipation Notes (TRAN) borrowing each year, and demonstrate the desire to restore its financial standing and gain creditworthiness of bond rating agencies and the financial community.

#### **Mitigate Effects of Economic Volatility and Uncertainty**

Being inadequately prepared for swings in revenues or unexpected expenditures can lead to short-term decisions with negative long-term implications. Economic downturns, even if they do not directly affect the City, can cause other agencies to reduce local revenues. During the early 1990's, the country went through a recession and the State of California reduced municipal revenues to balance its own budget. There were similar results during the economic impacts that followed the events of September 11, 2001, which not only impacted revenues as travel and consumer spending decreased, but also led to increased costs for needed security and safety responses to a new potential threat to the country and the City. Since the City had no significant reserves to draw upon, it faced unanticipated fiscal pressures that led to reductions in services, deferred maintenance, and poor decision-making. Adequate reserves will not eliminate the effect of such events, but will help mitigate the severity short-

term revenue and expenditure swings have on the City. Adequate reserves are an essential part of an emergency or disaster plan.

### **The Government Finance Officers Association (GFOA) Recommendations**

GFOA recommends that “governments establish a formal policy on the level of unreserved fund balance that should be maintained in the general fund. GFOA also encourages the adoption of similar policies for other types of governmental funds. Such a guideline should be set by the appropriate policy body and should provide both a temporal framework and specific plans for increasing or decreasing the level of unreserved fund balance, if it is inconsistent with that policy...GFOA recommends, at a minimum, that general-purpose governments, regardless of size, maintain unreserved fund balance in their general fund of no less than five to 15 percent of regular general fund operating revenues...”<sup>1</sup> In establishing a policy governing the level of emergency reserves in the General Fund, a government should consider a variety of factors, including:

- The predictability of its revenues and the volatility of its expenditures (i.e., a higher level of unreserved fund balance may be needed if significant revenue sources are subject to unpredictable fluctuations or if operating expenditures are highly volatile).
- The availability of resources in other funds as well as the potential drain upon general fund resources from other funds (i.e., the availability of resources in other funds may reduce the amount of unreserved fund balance needed in the general fund, just as deficits in other funds may require that a higher level of unreserved fund balance be maintained in the general fund).
- Liquidity (i.e., a disparity between when financial resources actually become available to make payments and the average maturity of related liabilities may require that a higher level of resources be maintained).
- Designations (i.e., governments may wish to maintain higher levels of unreserved fund balance to compensate for any portion of unreserved fund balance already designated for a specific purpose).

### **Obtain High-Quality Rating from Rating Agencies**

Rating agencies consider fund balance and reserve policy as a critical component of strong municipal management. In particular, the rating agencies look for a reserve policy which is a clearly delineated fiscal plan that includes a fund balance target level and the instances in which reserves may be used; the reserve levels that are clearly linked to the government's cash flow needs and the historic volatility of revenues and expenditures throughout economic cycles; and management historically adhering to the reserve policy. As noted by Moody's Investment Services, “Municipalities need to consider whether to govern their reserves through formal policy or through targeted levels. Most lending institutions tend to favor formal reserve policies because they minimize political considerations of adequate reserve levels. Some lending institutions are comfortable relying on municipality's long-term

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<sup>1</sup> “Appropriate Level of Unreserved Fund Balance in the General Fund” (2002). Government Finance Officers Association.

adherence to more informal policies, or targets, but informal policies have been associated with uneven long-term financial performance.”<sup>2</sup>

## **DEFINITIONS**

### **Working Capital**

For the purpose of this policy and when speaking of the core Emergency Reserves, the term “Reserves” is being used synonymously with “Working Capital.” Working Capital is defined as current assets (cash or equity in pooled cash and liquid investments and receivables (less than 60 days) minus current liabilities (payables) and encumbrances and other restrictions. Working Capital does not include long-term assets such as some longer term investments, loans receivable, fixed assets, inventory, and equipment.

### **Emergency Reserves**

Each fund will maintain an Emergency Reserve which by definition would only be used for qualifying emergencies as declared by the Mayor and/or the City Council and ultimately approved by the City Council. Approval by at least two-thirds of the City Council would be required to access the funds. The amount of the reserve for the General Fund would be calculated as a percentage of projected General Fund revenues for the subsequent fiscal year. Any incremental dollars needed to be set aside would be built into that budget. For Enterprise and Special Revenue Funds, the reserve amount would be based on a number of days of operation; for Internal Service Funds, the reserve amount would be based upon the needs and nature of the fund.

At least up to the established reserve level during any fiscal year, Emergency Reserves are only to be used in the case of a natural disaster or unforeseen catastrophic events caused by human activity such as terrorist attacks. Emergency Reserves would not be accessed to meet operating shortfalls or to fund new programs or personnel.

### **Appropriated Reserves**

In addition to the Emergency Reserves, certain funds may maintain reserves that would be set aside during the budget process as a contingency for unanticipated, non-emergency needs that are identified during the year. These reserves would only be drawn upon to fund unexpected expenditures or, in the case of Enterprise Funds, support operations due to unanticipated revenue shortfalls. Recommendations to use these funds would be brought forward by the Mayor or the City Council and would require approval by a majority of the City Council.

The Appropriated Reserve could be used to alleviate unanticipated expenditure (such as a spike in energy prices or materials cost), revenue shortfalls due to an unexpected economic slowdown or recession or to be used for one-time, high priority programs/activities.

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<sup>2</sup> “Fiscal Management/Reserves Are Essential to Fiscal Health”. John Incorvais, Moody’s Investment Services.

**Capital Reserves**

Capital Reserves (or Capital Improvement Program (CIP) Reserves) are intended to provide funding for unanticipated capital expenses. The use of these funds will require the City Council action.

**Dedicated Reserves**

Dedicated Reserves would be similar to Appropriated Reserves, but would be a set aside for specific purposes by the City Council during the budget process for projects or activities that take multiple years to fund. These funds shall automatically carryover to future budget years and not require any further appropriation of funds by the City Council so long as the funds are used for the pre-identified purpose(s). These types of reserves could also be used for special one-time purchases or major activities that have been approved by the City Council.

**Dedicated Reserve from Efficiency and Savings**

A Dedicated Reserve from Efficiency and Savings (DRES), one for the Water Fund and one for the Metropolitan Wastewater Fund (which is currently in place), will be used to protect and preserve savings found by increasing efficiencies, changing priorities or other actions related to reducing costs of the Capital Improvements Program (CIP) or operations and maintenance of either system. The DRES will track funds that can be used for accelerating CIP project schedules and will help offset the need for any future rate increases. Please refer to **Attachment I** for more detailed information.

**Operating Reserves**

The Operating Reserve in Enterprise Funds such as Water and Wastewater is intended to be used in the event of a catastrophe that prevents the utility from operating in its normal course of business. Use of the funds is restricted to emergency situations resulting from loss of revenue and must be replenished no later than the subsequent fiscal year. The Chief Operating Officer and/or Chief Financial Officer would have the authority to approve spending.

**Rate Stabilization Reserves**

The Rate Stabilization Reserves would be set aside to provide a source of funds to mitigate future rate increases in Enterprise Funds such as Water and Wastewater Enterprise Funds. Funds may be deposited into the reserve periodically during the fiscal year but usually at the end of the fiscal year. The funds would be used exclusively for the operation and maintenance of the water or wastewater systems.

**GENERAL FUND RESERVE POLICY**

The General Fund is used to account for all general revenues of the City not specifically levied or collected for other City funds and for expenditures related to the rendering of general services by the City. For the purpose of this Policy and as it applies to the General Fund only, until the City reaches a reserve level in excess of 8%, for purposes of calculating the City's General Fund Reserve level, the City shall combine the balance in the Emergency Reserve with the balance in the Appropriated Reserve in order to achieve the reserve balance percentages as outlined below. At no time during this period, however, shall the balance in

the General Fund Emergency Reserve fall below 5% unless specifically waived by the City Council because of an unforeseen emergency as defined in this Policy.

**Emergency Reserve (Unappropriated Reserve)**

The Emergency Reserve (Unappropriated Reserve) shall be set at a minimum of 8% of annual General Fund revenues. The City shall reach this level no later than fiscal year 2012 according to the following schedule:

<p>6.0% by June 30, 2008          6.5% by June 30, 2009          7.0% by June 30, 2010          7.5% by June 30, 2011          8.0% by June 30, 2012</p>
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**Appropriated Reserve**

An Appropriated Reserve may be maintained with the purpose of paying for unanticipated operational needs that arise during the fiscal year but not anticipated during the budget process. Funds appropriated to this Reserve will be identified and appropriated to a single account within the General Fund annual budget. There shall be no maximum or minimum amount appropriated to this Reserve in any given year. Any funds that are not expended in a given fiscal year will revert back to the General Fund's Emergency Reserve balance and may then be re-appropriated in the subsequent year, consistent with this Policy.

While funds in this Reserve are combined when describing the City's overall financial condition, this Reserve shall only be considered in addition to the Emergency Reserve and not as a replacement for a fully funded 8% Emergency Reserve (except as noted above on a temporary basis). Until fiscal year 2012, the Mayor will include an amount each year in the recommended operating budget to fund the Appropriated Reserve. Any expenditure of funds from this Reserve will be made based upon the recommendation of the Mayor or the City Council and approval by a majority of the City Council with the exception of the Appropriated Reserves of the Water and Wastewater Funds.

**DEVELOPMENT SERVICES FUND RESERVE POLICY**

Due to its uniqueness, the Development Services Department currently has three separate types of reserves. It is recommended that until a more in depth review of this fund can be completed, the current reserve policies should be continued.

The City shall maintain existing Development Services Fund balance designations and funding targets:

- **Operating Reserve**

The goal for the Development Services Fund is a 7% Operating Reserve. It is anticipated that the reserve balance will reach 7% by fiscal year 2013.

3.5% by June 30, 2009
4.0% by June 30, 2010
5.0% by June 30, 2011
6.0% by June 30, 2012
7.0% by June 30, 2013

- **Subdivision Account Liability**

Dedicated Reserves for Subdivision Account Liability will be maintained for the purpose of mitigating occasional short-term funding deficits on individual project accounts. In addition, a Work-in-Progress Liability Reserve will be maintained for the purpose of paying for expenses in which fees have already been collected. Neither Liability Reserves will have a maximum or minimum funding amount.

- **Work-in-Progress Liability (Unearned Revenue)**

This type of reserve is comprised of building permit fees that are collected in advance of the work being performed at the time a permit is issued. The Work-in-Progress Liability Reserve is the portion of the fees collected but not yet earned and covers the costs associated with inspecting the work as it is being completed. This reserve is in place so that, if all departmental revenues were not realized, funds would exist to pay inspectors to complete inspections for which fees have already been collected.

## **RISK MANAGEMENT RESERVE POLICY**

### **Public Liability Fund**

The City shall maintain Dedicated Reserves equal to but not less than 50% of the value of the outstanding claims. This level recognizes that not all claims will become due and payable at one point in time, yet there may be more than one large claim that could require an immediate payment.

A reserve amount of 50% shall be achieved no later than fiscal year 2014 based on the following schedule:

5% by June 30, 2008
10% by June 30, 2009
15% by June 30, 2010
25% by June 30, 2011
35% by June 30, 2012
45% by June 30, 2013
50% by June 30, 2014

### **Workers' Compensation Fund Reserve Policy**

The City shall maintain Dedicated Reserves equal to but not less than 50% of the value of the outstanding claims.

Workers' Compensation Fund is a citywide fund that addresses workers' compensation claims

for all departments and all funds. In addition, there are citywide rates charged in order to properly fund current year and future liabilities. The City implemented a funding strategy that adds \$2 million annually towards the reserve each year.

A reserve amount of 50% shall be achieved no later than fiscal year 2014 based on the following schedule:

12% by June 30, 2008
15% by June 30, 2009
22% by June 30, 2010
30% by June 30, 2011
35% by June 30, 2012
42% by June 30, 2013
50% by June 30, 2014

#### **Long-Term Disability Fund Reserve Policy**

Currently, the balance in the Long-Term Disability (LTD) Fund is estimated at approximately \$3.0 million. The reserve level in this fund shall be established to equal \$12 million by fiscal year 2012 as recommended in the Long-Term Disability Actuarial report. The City shall increase the reserve by a minimum of \$2.25 million in fiscal year 2009 and a minimum of \$2.25 million annually thereafter to achieve the reserve target of \$12 million by fiscal year 2012. A study will be undertaken to determine the feasibility for purchasing an insurance policy to cover this benefit as an alternative to the current practice of self-insurance.

#### **WATER ENTERPRISE FUND RESERVE POLICY**

##### **Appropriated Reserve**

This reserve is budgeted annually at the discretion of the Water Department to provide for unanticipated needs that may arise during the course of the year. If this Reserve is used to cover unanticipated operating expenses, only the Department Director's approval is required; however, if used for unanticipated capital needs, City Council action is required.

##### **Operating Reserve**

This reserve is intended to be used in the event of a catastrophe that prevents the utility from operating in its normal course of business. This reserve is calculated based on the annual operating budget for the fiscal year (less water purchases and the Appropriated Reserve) which represents the amount necessary to provide for a certain number of days of operations in the event of a major disruption to the Water Fund revenues. Use of the funds is restricted to emergency situations resulting from loss of revenue and must be replenished during the fiscal year. The fiscal year 2008 budget for this reserve includes approximately \$23.1 million for 50 days of operations. The schedule below provides the proposed reserve balances for upcoming fiscal years with the plan to bring this reserve to a 70-day reserve by fiscal year 2013:

	<u>(Days of Operations)</u>
FY 2009 – \$27.2 million	(55)
FY 2010 – \$31.9 million	(60)
FY 2011 – \$36.8 million	(65)
FY 2012 – \$38.1 million	(70)
FY 2013 – \$40.0 million	(70)

### **Capital Reserve**

This reserve is budgeted annually at \$5.0 million in the Capital Improvements Budget (CIP). The reserve is intended for unanticipated capital needs. Use of these funds for a CIP project other than the original project designation (project transfer) requires City Council action.

### **Rate Stabilization Reserve**

Historically, this reserve is an unbudgeted amount. It is proposed that this policy will serve to keep a stable balance of \$20.5 million in this reserve in order to mitigate future rate increases. Deposits into the reserve are made from current system revenues. Use of the funds is to be limited only for the operation and maintenance of the water system.

The utilization of this Reserve during the course of the fiscal year does not require City Council action but may be used based upon the recommendation of the Department and approval of the Chief Financial Officer.

### **Secondary Purchase Reserve**

Historically, this reserve is an unbudgeted amount. The proposed policy calls for the size of the reserve to equal 6% of the annual water purchase budget. The reserve may be funded by any lawful source. Withdrawal from the reserves will be necessary for the purchase of water should a major drought or emergency occur that diminishes the City's normal supply. The City Council action is required in order to appropriate these reserves into a program.

### **Dedicated Reserve from Efficiency and Savings (DRES)**

Beginning in fiscal year 2008, two reserves, one for the Water Fund and one for the Metropolitan Wastewater Fund (which is currently in place), will be used to protect and preserve savings found by increasing efficiencies, changing priorities or other actions related to reducing costs of the Capital Improvements Program (CIP) or operations and maintenance of either system. The DRES will track funds that can be used for accelerating CIP project schedules and will help offset the need for any future rate increases. At the end of each fiscal year, any savings not required for compliance with established reserve policies will be transferred into this reserve. At the end of four years, any funds transferred into this reserve and not used for capital improvements will be used to lower future rates for the water and wastewater systems.

## **WASTEWATER ENTERPRISE FUND RESERVE POLICY**

### **Appropriated Reserve**

The Appropriated Reserve is budgeted annually for unanticipated expenditures. It may be used to fund either operating or capital needs. If this reserve is used to cover unanticipated

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operating expenses, the Department Director's approval is required; however, if used for unanticipated capital needs, City Council action is required.

Current reserve levels are budgeted at \$3.3 million with intent to keep the reserve balance at the same level for future years based on historical requirements. An annual review of this level should be undertaken to determine adequate funding levels.

### **Operating Reserve**

This reserve is intended to be used in the event of a catastrophe that prevents the utility from operating in its normal course of business. This Reserve is calculated based on the annual operating budget for the fiscal year. The Fiscal Year 2008 Budget for this reserve includes approximately \$31.6 million. The schedule below provides the proposed reserve balances for upcoming fiscal years with the plan to bring this reserve to a 70-day reserve by fiscal year 2013:

	<u>(Days of Operations)</u>
FY 2009 – \$31.6 million	(50)
FY 2010 – \$31.7 million	(50)
FY 2011 – \$35.9 million	(55)
FY 2012 – \$40.1 million	(60)
FY 2013 – \$48.1 million	(70)

### **Capital Reserve**

The CIP Reserve is budgeted as a separate CIP Reserve at a level of \$5.0 million. Use of this reserve may only be used for capital costs. The City Council action is required for any withdrawal from the reserve.

### **Rate Stabilization Fund**

This reserve is identical in rationale with the Rate Stabilization for the Water Fund: a source of funds used to mitigate future rate increases. It is expected that this reserve will reach \$13.3 million in fiscal year 2008. This reserve will be maintained at a level of 20% of system revenues less operating and non-operating expenses. The following are projected dollar targets to be achieved each year and will be adjusted based on 20% of actual revenues (less operating and non-operating expenses):

FY 2009 — \$19.3 million
FY 2010 — \$20.3 million
FY 2011 and beyond — maintain \$20.3 million

The utilization of this reserve during the course of the fiscal year does not require City Council action but may be used based upon the recommendation of the Department and approval of the Chief Financial Officer.

### **Dedicated Reserve from Efficiency and Savings (DRES)**

Beginning in fiscal year 2008, two reserves, one for the Water Fund and one for the Metropolitan Wastewater Fund (which is currently in place), will be used to protect and preserve savings found by increasing efficiencies, changing priorities or other actions related to reducing costs of the Capital Improvements Program (CIP) or operations and maintenance

of either system. The DRES will track funds that can be used for accelerating CIP project schedules and will help offset the need for any future rate increases. At the end of each fiscal year, any savings not required for compliance with established reserve policies will be transferred into this reserve. At the end of four years, any funds transferred into this reserve and not used for capital improvements will be used to lower future rates for the water and wastewater systems.

## **AUTHORITY**

### **Fiscal Reserve Policy**

It is recommended that as a matter of policy, any changes, additions, deletions to the Fiscal Reserve Policy must be brought forward to the Budget and Finance Committee for review followed by a presentation to the City Council for formal action.

Quarterly status reports will be provided to the Budget and Finance Committee and the City Council. In addition, any requests for the use of reserves will be accompanied by current status report of the affected reserve fund.

### **Deviations from the Policy**

No deviations from the Fiscal Reserve Policy will be allowed except as recommended by the Mayor or the City Council, and approved by the City Council. This would include increasing or decreasing the basis of emergency reserves, expenditures from reserves for anything other than the intended use of said reserve, and expenditures from any fund balances above the stated basis of the emergency reserves. If one is requested, it must be first presented to the Chief Financial Officer for review of the fiscal impact and to determine its appropriateness. The Chief Financial Officer will then bring the request to the Chief Operating Officer and the Mayor with a recommendation followed by a presentation to the Budget and Finance Committee. After the Budget and Finance Committee review, the item will be presented to the City Council for action.

### **Reserve Expenditures**

Unless specified above, the authority to make expenditures from all reserves for all funds shall lie with the Mayor and City Council. Either the Mayor or the City Council may make recommendations for expenditures either through the budget process for dedicated or replacement reserves, or in the case of emergency or appropriated reserve expenditures, at regular or special City Council meetings.

### **Replenishment of Reserves**

Should a particular reserve fall below the anticipated reserve level as stated in this Policy, the Mayor will bring forward a plan as part of the subsequent fiscal year budget to the Budget and Finance Committee and ultimately the City Council to replenish said reserve in a reasonable timeframe.

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EFFECTIVE DATE

The Reserve Policy shall be effective upon Council Approval.

CONCLUSION

The fiscal impact of this policy is to provide for adequate cash balances to ensure that the City meets its cash flow obligations, maximizes earnings on investments, minimizes borrowing costs and maintains the highest credit rating on its bonds.

The Reserve Policy shall serve as a cornerstone for other budgetary and financial decisions. The Policy should be reviewed and discussed no less frequent than every two years. This review would examine the effectiveness of the current policy and would make recommendations for any modifications which may be prudent. This will ensure that the policy remains current with general accounting and finance best practices as well as any regulatory or standards changes that may emerge over time.

The key factor of the reserve policy is to develop the fiscal disciplines that should be strictly followed. Sound fiscal management practices will be required to ensure that reserves are maintained and properly used.

Respectfully submitted,

Jay M. Goldstone  
Chief Financial Officer/Interim Chief Operating Officer

CC: Honorable Mayor Jerry Sanders  
Members of the City Council  
Mary Lewis, Financial Management Director  
Andrea Tevlin, Independent Budget Analyst  
Greg Levin, City Comptroller

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## Dedicated Reserve from Efficiencies and Savings

### Purpose:

The City will establish a means to identify, track and secure year-to-year budget savings that occur in the Water and Wastewater Departments (Funds). These savings will be specifically identified in the City's general ledger and can be audited. This policy will remain in effect for a period no less than the duration of the fiscal year 2007 four-year rate case. The savings will be used for water and wastewater capital projects, respectively or to minimize future rate increases.

### A. The Establishment of Dedicated Reserves:

1. The City will establish a Reserve Account within the respective Water and Wastewater Funds entitled "Dedicated Reserves from Efficiencies and Savings" (Reserve).
2. A semi-annual report will be issued to the Independent Rates Oversight Committee (IROC) which identifies any transfers to or from this Reserve during the prior.
3. At the end of each fiscal year, any savings not required to comply with established policies or legal documents will be transferred into the Reserve.
4. At the end of the four years, any funds transferred into this Reserve and not used for capital improvements will be used to lower future rates.
5. Nothing in this policy will interfere in any way with any contractual or legal obligations entered into by the Departments, including but not limited to any rate covenants in any bond indenture.

### B. Capital Improvements (CIP):

1. CIP projects to be funded as part of the rate case will be monitored on a project by project basis.
2. At the point in time when the construction contract is awarded, should the projected project cost be larger than anticipated, the budget will be amended and a funding source identified. To the extent there are funds in the Reserve, the funding will be transferred from the Reserve.
3. Quarterly, a project savings report will be prepared and presented to the IROC. Any savings identified will be transferred to the Reserve.

### C. Operations and Maintenance (O&M):

1. The operations and maintenance budgets as presented in the 2007-08 budget case will be monitored on a line item basis and financial results will be reported to the IROC on a quarterly basis.

At the end of the fiscal year, any O&M savings will be transferred to the Reserve.



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THE CITY OF SAN DIEGO  
**REPORT TO THE CITY COUNCIL**

DATE ISSUED: October 17, 2007 REPORT NO:07-163  
ATTENTION: Council President and City Council  
October 22, 2007  
SUBJECT: City Reserve Policy  
REFERENCE: City Reserve Policy Memorandum

REQUESTED ACTION:

1. Approve the City Reserve Policy.
2. Establish the Appropriated Reserve Department 602 in the General Fund and appropriate \$7,000,000 from the General Fund Unallocated Reserve to Department 602 to establish a General Fund Appropriated Reserve for Fiscal Year 2008.

STAFF RECOMMENDATION:

Approve the requested actions.

SUMMARY:

**1. City Reserve Policy**

One of the indicators of a financially stable organization is the establishment and maintenance of appropriate reserves and the adoption of a prudent reserve policy. While the City of San Diego has a reserve objective, it does not have a clearly delineated policy to govern decision-making and fiscal actions by its officials. This is essential, especially as the City works to restore its financial standing in the bond community. The specific goals of the City Reserve Policy (Policy) are threefold: to insure that all decisions made by City's officials are made with the preservation of the City's fiscal health in mind; to protect the City's assets from economic turbulence and emergencies while avoiding reactive decision-making; restore San Diego's financial standing in the bond community by ensuring the City meets all of its short-term and long-term obligations.

The City Reserve Policy recommends that an Appropriated Reserve and an Emergency Reserve be established for the General Fund. The Emergency Reserve would only be used for qualifying emergencies as declared by the Mayor and/or the City Council and funds could only be accessed by two-thirds vote of the City Council. This Reserve may be a component of the City Charter Section 91 requirement to establish and fund a General Reserve Fund. Staff will return to the City Council at a later date once the requirements of Charter Section 91 are clear.

The City Reserve Policy includes a General Fund Appropriated Reserve. The purpose the Appropriated Reserve is to fund operational needs that are not anticipated during the development of the annual budget. Staff recommends that a General Fund Appropriated Reserve be established and funded for unanticipated needs in Fiscal Year 2008 with an appropriation of \$7,000,000 from the General Fund Unallocated Reserve. This amount represents a suggested appropriation of \$10 million less those amounts already transferred from the Unallocated Reserve during Fiscal Year 2008. Starting in Fiscal Year 2009 and in subsequent years, the General Fund Appropriated Reserve would be budgeted annually during the annual budget process. There would be no maximum or minimum amount appropriated to this Reserve in any given year. Any funds that are not expended in a given fiscal year will revert back to the General Fund unallocated fund balance (the Unallocated Reserve) which may then be re-appropriated in the subsequent fiscal year. Any expenditure of funds from this Appropriated Reserve will be made based upon the recommendation of the Mayor or the City Council and approval by a majority of the City Council by way of resolution.

From time to time there may be accumulated funds in the General Fund Unallocated Reserve which exceed the percentage required under the City Reserve Policy. These "excess" funds may be available for the City Council to appropriate consistent with the City Charter requirements and the Municipal Code.

In addition to the General Fund Emergency and Appropriated Reserves, this Policy addresses the reserves that other City funds may establish during the budget process as a contingency for unanticipated, non-emergency needs that are identified during the year. These appropriated reserves would only be drawn upon to fund unexpected expenditures or, in the case of Enterprise Funds, support operations due to unanticipated revenue shortfalls. Recommendations to use these funds would be brought forward by the Mayor or the City Council and would require approval by a majority of the City Council.

## **2. Establish an Appropriated Reserve for Fiscal Year 2008**

Staff recommends the establishment of the General Fund Appropriated Reserve Department 602 and requests an appropriation of \$7,000,000 from the General Fund Unallocated Reserve for Fiscal Year 2008. This amount is based upon an estimated appropriated reserve requirement of \$10,000,000 for Fiscal Year 2008 less the \$3,000,000 appropriated to date by City Council for unanticipated needs from the General Fund Unallocated Reserve.

### FISCAL CONSIDERATIONS:

The amount of \$7,000,000 to establish the General Fund Appropriated Reserve will be appropriated from the General Fund Unallocated Reserve, reducing the General Fund Unallocated Reserve. Information on the current status of the General Fund Unallocated Reserve and the effect of this action on the General Fund Reserve is attached to this Report.

PREVIOUS COUNCIL and/or COMMITTEE ACTION:

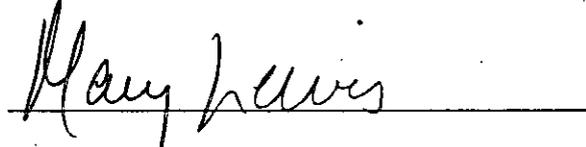
1. The Budget and Finance Committee reviewed the City Reserve Policy on July 11, 2007, July 25, 2007 and September 26, 2007. Revisions presented by the Office of the Independent Budget Analyst and Committee Members have been incorporated. The Committee has recommended forwarding the proposed City Reserve Policy to the full Council for approval.

COMMUNITY PARTICIPATION AND PUBLIC OUTREACH EFFORTS:

None.

KEY STAKEHOLDERS AND PROJECTED IMPACTS:

None.



Mary J. Lewis  
Director  
Financial Management Department



Jay M. Goldstone  
Chief Operating Officer

Attachments: City Reserve Policy  
Estimated General Fund Working Capital

## Dedicated Reserve from Efficiencies and Savings

### Purpose:

The City will establish a means to identify, track and secure year-to-year budget savings that occur in the Water and Wastewater Departments (Funds). These savings will be specifically identified in the City's general ledger and can be audited. This policy will remain in effect for a period no less than the duration of the fiscal year 2007 four-year rate case. The savings will be used for water and wastewater capital projects, respectively or to minimize future rate increases.

### A. The Establishment of Dedicated Reserves:

1. The City will establish a Reserve Account within the respective Water and Wastewater Funds entitled "Dedicated Reserves from Efficiencies and Savings" (Reserve).
2. A semi-annual report will be issued to the Independent Rates Oversight Committee (IROC) which identifies any transfers to or from this Reserve during the prior.
3. At the end of each fiscal year, any savings not required to comply with established policies or legal documents will be transferred into the Reserve.
4. At the end of the four years, any funds transferred into this Reserve and not used for capital improvements will be used to lower future rates.
5. Nothing in this policy will interfere in any way with any contractual or legal obligations entered into by the Departments, including but not limited to any rate covenants in any bond indenture.

### B. Capital Improvements (CIP):

1. CIP projects to be funded as part of the rate case will be monitored on a project by project basis.
2. At the point in time when the construction contract is awarded, should the projected project cost be larger than anticipated, the budget will be amended and a funding source identified. To the extent there are funds in the Reserve, the funding will be transferred from the Reserve.
3. Quarterly, a project savings report will be prepared and presented to the IROC. Any savings identified will be transferred to the Reserve.

### C. Operations and Maintenance (O&M):

1. The operations and maintenance budgets as presented in the 2007-08 budget case will be *monitored on a line item basis and financial results will be reported to the IROC on a quarterly basis.*

At the end of the fiscal year, any O&M savings will be transferred to the Reserve.

Estimated General Fund Working Capital (Unaudited)

2007 Ending Cash or Equity in Pooled Cash and Investments	\$	95,817,310
Receivables (Due Within 60 Days)		63,832,530
Payables		(33,687,584)
<u>Working Capital Beginning Balance</u>		<u>125,962,257</u>
Encumbrances		(34,029,552)
Other Restrictions		(1,150,857)
		<u>(35,180,410)</u>
Total Working Capital at 07-01-07		<u>90,781,847</u>
Actions Taken Since 7-1-07 (Macias, Gini & O'Connell, LLP)		(688,000)
Amounts Encumbered Waiting for Action (Charger's Settlement)		(1,980,340)
New Action (Hawkins Delafield & Wood)		(369,500)
New Action (Appropriate Reserve)		(7,000,000)
<b>Total Working Capital</b>		<b><u>80,744,007</u></b>



THE CITY OF SAN DIEGO  
MAYOR JERRY SANDERS

**M E M O R A N D U M**

DATE : October 12, 2007  
TO: Budget and Finance Committee  
FROM: Jay M. Goldstone, Chief Operating Officer  
SUBJECT: City Reserve Policy

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**INTRODUCTION**

The following represents a comprehensive reserve policy for the major funds of the City of San Diego and recommends a phased approach in setting reserve levels.

One of the key components of a financially stable organization is the establishment and maintenance of appropriate reserves and the adoption of a prudent reserve policy. While the City of San Diego has a reserve objective, it does not have a clearly delineated policy to govern decision-making and fiscal actions by its officials. This is essential, especially as the City works to restore its financial standing in the bond community.

**OBJECTIVES**

- A. Establish sound formal fiscal reserve policies. These policies will be the foundation for ensuring that strong fiscal management and policies guide future City decisions.
- B. Build adequate reserves. This action will provide the City with resources to help stabilize the organization and will position it during economic downturns or large-scale emergencies. In addition, it is critical to minimize the potential for reactive decision-making which often leads to poor choices and unpleasant consequences.
- C. Guide the City toward meeting its short-term and long-term obligations and to ensure that the City maintains the highest credit rating possible.

**BACKGROUND**

City Charter Section 91 stipulates that the City maintain a "General Reserve Fund" to meet the cash obligations of the City for four months or prior to the collection of taxes. The fund

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may only be expended in an emergency, requiring a two-thirds vote by the City Council. On September 27, 2007, the City Attorney's Office issued an opinion on City Charter Section 91 that states: "To the extent that the City has cash on hand to cover four months of the fiscal year prior to the receipt of taxes, the charter provision would be satisfied by funding at a fiscally prudent level of 5% to 15%." A separate fund, the General Reserve Fund, described in this policy as the "Emergency Reserves" will be established and funded. In addition to emergency reserves, the operating cash needs of the General Fund will continue to be met through the liquidity portfolio established by the City Treasurer's Investment Policy, which is approved by City Council.

The Investment Policy stipulates that the City's pooled investment fund shall be comprised of a core and liquidity portfolio. The liquidity portfolio is designed to ensure that the projected expenditures and related demands for cash can be met over a six month period. Cash flows are calculated and monitored to determine the required amount of operating cash. The liquidity portfolio established by the Investment Policy meets and exceeds the City Charter Section 91 which requires the City to have an available source of cash in order to meet the legal demands against the City for the first four months of each fiscal year prior to the collection of taxes. The City has historically borrowed funds (Tax Revenue Anticipation Notes) at the beginning of each fiscal year to ensure that there is sufficient cash prior to the receipt of property tax.

On October 15, 2002, the City Council adopted the General Fund Reserve Policy which established and maintained a General Fund Reserve level that is sufficient to address unforeseen contingencies such as natural disasters, catastrophic occurrences, or excessive liabilities or judgments against the City. The Reserve Policy specified that the General Fund Reserve should be set at a minimum of 3% of annual General Fund revenues with a goal of establishing the General Fund Reserve at 5% of annual General Fund revenues by fiscal year 2014. Considering the recommendations of the rating agencies (Standard and Poor's, Moody's, and Fitch Ratings) and the need to demonstrate the ability to weather fluctuations in revenue and unforeseen expenditure pressures, reserves greater than 5% need to be established through a defined policy.

The reserve policy recommends that the City establish and maintain appropriate reserves for the City's major funds. Adequate reserve levels would allow the City to withstand short-term revenue and expenditure swings which can result in short-term decisions with negative long-term implications, mitigate the impact of economic downturns that result in reduced municipal revenues from the State, respond to the budgetary affects of natural disasters or other catastrophic events, excessive liabilities or legal judgments against the City, reduce the amount of Tax Revenue Anticipation Notes (TRAN) borrowing each year, and demonstrate the desire to restore its financial standing and gain creditworthiness of bond rating agencies and the financial community.

#### **Mitigate Effects of Economic Volatility and Uncertainty**

Being inadequately prepared for swings in revenues or unexpected expenditures can lead to short-term decisions with negative long-term implications. Economic downturns, even if they do not directly affect the City, can cause other agencies to reduce local revenues. During the early 1990's, the country went through a recession and the State of California reduced

municipal revenues to balance its own budget. There were similar results during the economic impacts that followed the events of September 11, 2001, which not only impacted revenues as travel and consumer spending decreased, but also led to increased costs for needed security and safety responses to a new potential threat to the country and the City. Since the City had no significant reserves to draw upon, it faced unanticipated fiscal pressures that led to reductions in services, deferred maintenance, and poor decision-making. Adequate reserves will not eliminate the effect of such events, but will help mitigate the severity short-term revenue and expenditure swings have on the City. Adequate reserves are an essential part of an emergency or disaster plan.

### **The Government Finance Officers Association (GFOA) Recommendations**

GFOA recommends that “governments establish a formal policy on the level of unreserved fund balance that should be maintained in the general fund. GFOA also encourages the adoption of similar policies for other types of governmental funds. Such a guideline should be set by the appropriate policy body and should provide both a temporal framework and specific plans for increasing or decreasing the level of unreserved fund balance, if it is inconsistent with that policy GFOA recommends, at a minimum, that general-purpose governments, regardless of size, maintain unreserved fund balance in their general fund of no less than five to 15 percent of regular general fund operating revenues...”<sup>1</sup> In establishing a policy governing the level of emergency reserves in the General Fund, a government should consider a variety of factors, including:

- The predictability of its revenues and the volatility of its expenditures (i.e., a higher level of unreserved fund balance may be needed if significant revenue sources are subject to unpredictable fluctuations or if operating expenditures are highly volatile).
- The availability of resources in other funds as well as the potential drain upon general fund resources from other funds (i.e., the availability of resources in other funds may reduce the amount of unreserved fund balance needed in the general fund, just as deficits in other funds may require that a higher level of unreserved fund balance be maintained in the general fund).
- Liquidity (i.e., a disparity between when financial resources actually become available to make payments and the average maturity of related liabilities may require that a higher level of resources be maintained).
- Designations (i.e., governments may wish to maintain higher levels of unreserved fund balance to compensate for any portion of unreserved fund balance already designated for a specific purpose).

### **Obtain High-Quality Rating from Rating Agencies**

Rating agencies consider fund balance and reserve policy as a critical component of strong municipal management. In particular, the rating agencies look for a reserve policy which is a clearly delineated fiscal plan that includes a fund balance target level and the instances in which reserves may be used; the reserve levels that are clearly linked to the government’s cash flow needs and the historic volatility of revenues and expenditures throughout economic

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<sup>1</sup> “Appropriate Level of Unreserved Fund Balance in the General Fund” (2002). Government Finance Officers Association.

cycles; and management historically adhering to the reserve policy. As noted by Moody's Investment Services, "Municipalities need to consider whether to govern their reserves through formal policy or through targeted levels. Most lending institutions tend to favor formal reserve policies because they minimize political considerations of adequate reserve levels. Some lending institutions are comfortable relying on municipality's long-term adherence to more informal policies, or targets, but informal policies have been associated with uneven long-term financial performance."<sup>2</sup>

## **DEFINITIONS**

### **Working Capital**

For the purpose of this policy and when speaking of the core Emergency Reserves, the term "Reserves" is being used synonymously with "Working Capital." Working Capital is defined as current assets (cash or equity in pooled cash and liquid investments and receivables (less than 60 days) minus current liabilities (payables) and encumbrances and other restrictions. Working Capital does not include long-term assets such as some longer term investments, loans receivable, fixed assets, inventory, and equipment.

### **Emergency Reserves**

Each fund will maintain an Emergency Reserve which by definition would only be used for qualifying emergencies as declared by the Mayor and/or the City Council and ultimately approved by the City Council. Approval by at least two-thirds of the City Council would be required to access the funds. The amount of the reserve for the General Fund would be calculated as a percentage of projected General Fund revenues for the subsequent fiscal year. Any incremental dollars needed to be set aside would be built into that budget. For Enterprise and Special Revenue Funds, the reserve amount would be based on a number of days of operation; for Internal Service Funds, the reserve amount would be based upon the needs and nature of the fund.

At least up to the established reserve level during any fiscal year, Emergency Reserves are only to be used in the case of a natural disaster or unforeseen catastrophic events caused by human activity such as terrorist attacks. Emergency Reserves would not be accessed to meet operating shortfalls or to fund new programs or personnel.

### **Appropriated Reserves**

In addition to the Emergency Reserves, certain funds may maintain reserves that would be set aside during the budget process as a contingency for unanticipated, non-emergency needs that are identified during the year. These reserves would only be drawn upon to fund unexpected expenditures or, in the case of Enterprise Funds, support operations due to unanticipated revenue shortfalls. Recommendations to use these funds would be brought forward by the Mayor or the City Council and would require approval by a majority of the City Council.

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<sup>2</sup> "Fiscal Management/Reserves Are Essential to Fiscal Health". John Incorvais. Moody's Investment Services.

The Appropriated Reserve could be used to alleviate unanticipated expenditure (such as a spike in energy prices or materials cost), revenue shortfalls due to an unexpected economic slowdown or recession or to be used for one-time, high priority programs/activities.

### **Capital Reserves**

Capital Reserves (or Capital Improvement Program (CIP) Reserves) are intended to provide funding for unanticipated capital expenses. The use of these funds will require the City Council action.

### **Dedicated Reserves**

Dedicated Reserves would be similar to Appropriated Reserves, but would be set aside for specific purposes by the City Council during the budget process for non-capital projects or activities that take multiple years to fund. (Capital project funding allocated by City Council carries over from year to year until the project is completed or closed.) These dedicated reserves are restricted funds that shall only be used for the identified purpose(s). City Council may review the dedicated reserves annually during the budget process and carryover the funds to future fiscal years. These types of reserves could also be used for special one-time purchases or major activities that have been approved by the City Council.

### **Dedicated Reserve from Efficiency and Savings**

A Dedicated Reserve from Efficiency and Savings (DRES), one for the Water Fund and one for the Metropolitan Wastewater Fund (which is currently in place), will be used to protect and preserve savings found by increasing efficiencies, changing priorities or other actions related to reducing costs of the Capital Improvements Program (CIP) or operations and maintenance of either system. The DRES will track funds that can be used for accelerating CIP project schedules and will help offset the need for any future rate increases. Please refer to **Attachment I** for more detailed information.

### **Operating Reserves**

The Operating Reserve in Enterprise Funds such as Water and Wastewater is intended to be used in the event of a catastrophe that prevents the utility from operating in its normal course of business. Use of the funds is restricted to emergency situations resulting from loss of revenue and must be replenished no later than the subsequent fiscal year. The Chief Operating Officer and/or Chief Financial Officer would have the authority to approve spending.

### **Rate Stabilization Reserves**

The Rate Stabilization Reserves would be set aside to provide a source of funds to mitigate future rate increases in Enterprise Funds such as Water and Wastewater Enterprise Funds. Funds may be deposited into the reserve periodically during the fiscal year but usually at the end of the fiscal year. The funds would be used exclusively for the operation and maintenance of the water or wastewater systems.

## **GENERAL FUND RESERVE POLICY**

The General Fund is used to account for all general revenues of the City not specifically levied or collected for other City funds and for expenditures related to the rendering of

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general services by the City. For the purpose of this Policy and as it applies to the General Fund only, until the City reaches a reserve level in excess of 8%, for purposes of calculating the City's General Fund Reserve level, the City shall combine the balance in the Emergency Reserve with the balance in the Appropriated Reserve in order to achieve the reserve balance percentages as outlined below. At no time during this period, however, shall the balance in the General Fund Emergency Reserve fall below 5% unless specifically waived by the City Council because of an unforeseen emergency as defined in this Policy.

**Emergency Reserve (Unappropriated Reserve)**

The Emergency Reserve (Unappropriated Reserve) shall be set at a minimum of 8% of annual General Fund revenues. The City shall reach this level no later than fiscal year 2012 according to the following schedule:

<b>6.0% by June 30, 2008</b>
<b>6.5% by June 30, 2009</b>
<b>7.0% by June 30, 2010</b>
<b>7.5% by June 30, 2011</b>
<b>8.0% by June 30, 2012</b>

**Appropriated Reserve**

An Appropriated Reserve may be maintained with the purpose of paying for unanticipated operational needs that arise during the fiscal year but not anticipated during the budget process. Funds appropriated to this Reserve will be identified and appropriated to a single account within the General Fund annual budget. There shall be no maximum or minimum amount appropriated to this Reserve in any given year. Any funds that are not expended in a given fiscal year will revert back to the General Fund's Emergency Reserve balance and may then be re-appropriated in the subsequent year, consistent with this Policy.

While funds in this Reserve are combined when describing the City's overall financial condition, this Reserve shall only be considered in addition to the Emergency Reserve and not as a replacement for a fully funded 8% Emergency Reserve (except as noted above on a temporary basis). Until fiscal year 2012, the Mayor will include an amount each year in the recommended operating budget to fund the Appropriated Reserve. Any expenditure of funds from this Reserve will be made based upon the recommendation of the Mayor or the City Council and approval by a majority of the City Council with the exception of the Appropriated Reserves of the Water and Wastewater Funds.

**DEVELOPMENT SERVICES FUND RESERVE POLICY**

Due to its uniqueness, the Development Services Department currently has three separate types of reserves. It is recommended that until a more in depth review of this fund can be completed, the current reserve policies should be continued.

The City shall maintain existing Development Services Fund balance designations and funding targets:

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- **Operating Reserve**

The goal for the Development Services Fund is a 7% Operating Reserve. It is anticipated that the reserve balance will reach 7% by fiscal year 2013.

<b>3.5% by June 30, 2009</b>
<b>4.0% by June 30, 2010</b>
<b>5.0% by June 30, 2011</b>
<b>6.0% by June 30, 2012</b>
<b>7.0% by June 30, 2013</b>

- **Subdivision Account Liability**

Dedicated Reserves for Subdivision Account Liability will be maintained for the purpose of mitigating occasional short-term funding deficits on individual project accounts. In addition, a Work-in-Progress Liability Reserve will be maintained for the purpose of paying for expenses in which fees have already been collected. Neither Liability Reserves will have a maximum or minimum funding amount.

- **Work-in-Progress Liability (Unearned Revenue)**

This type of reserve is comprised of building permit fees that are collected in advance of the work being performed at the time a permit is issued. The Work-in-Progress Liability Reserve is the portion of the fees collected but not yet earned and covers the costs associated with inspecting the work as it is being completed. This reserve is in place so that, if all departmental revenues were not realized, funds would exist to pay inspectors to complete inspections for which fees have already been collected.

## **RISK MANAGEMENT RESERVE POLICY**

### **Public Liability Fund**

The City shall maintain Dedicated Reserves equal to but not less than 50% of the value of the outstanding claims. This level recognizes that not all claims will become due and payable at one point in time, yet there may be more than one large claim that could require an immediate payment.

A reserve amount of 50% shall be achieved no later than fiscal year 2014 based on the following schedule:

<b>5% by June 30, 2008</b>
<b>10% by June 30, 2009</b>
<b>15% by June 30, 2010</b>
<b>25% by June 30, 2011</b>
<b>35% by June 30, 2012</b>
<b>45% by June 30, 2013</b>
<b>50% by June 30, 2014</b>

**Workers' Compensation Fund Reserve Policy**

The City shall maintain Dedicated Reserves equal to but not less than 50% of the value of the outstanding claims.

Workers' Compensation Fund is a citywide fund that addresses workers' compensation claims for all departments and all funds. In addition, there are citywide rates charged in order to properly fund current year and future liabilities. The City implemented a funding strategy that adds \$2 million annually towards the reserve each year.

A reserve amount of 50% shall be achieved no later than fiscal year 2014 based on the following schedule:

<b>12% by June 30, 2008</b>
<b>15% by June 30, 2009</b>
<b>22% by June 30, 2010</b>
<b>30% by June 30, 2011</b>
<b>35% by June 30, 2012</b>
<b>42% by June 30, 2013</b>
<b>50% by June 30, 2014</b>

**Long-Term Disability Fund Reserve Policy**

Currently, the balance in the Long-Term Disability (LTD) Fund is estimated at approximately \$3.0 million. The reserve level in this fund shall be established to equal \$12 million by fiscal year 2012 as recommended in the Long-Term Disability Actuarial report. The City shall increase the reserve by a minimum of \$2.25 million in fiscal year 2009 and a minimum of \$2.25 million annually thereafter to achieve the reserve target of \$12 million by fiscal year 2012. A study will be undertaken to determine the feasibility for purchasing an insurance policy to cover this benefit as an alternative to the current practice of self-insurance.

**WATER ENTERPRISE FUND RESERVE POLICY**

**Appropriated Reserve**

This reserve is budgeted annually at the discretion of the Water Department to provide for unanticipated needs that may arise during the course of the year. If this Reserve is used to

cover unanticipated operating expenses, only the Department Director's approval is required; however, if used for unanticipated capital needs, City Council action is required.

**Operating Reserve**

This reserve is intended to be used in the event of a catastrophe that prevents the utility from operating in its normal course of business. This reserve is calculated based on the annual operating budget for the fiscal year (less water purchases and the Appropriated Reserve) which represents the amount necessary to provide for a certain number of days of operations in the event of a major disruption to the Water Fund revenues. Use of the funds is restricted to emergency situations resulting from loss of revenue and must be replenished during the fiscal year. The fiscal year 2008 budget for this reserve includes approximately \$23.1 million for 50 days of operations. The schedule below provides the proposed reserve balances for upcoming fiscal years with the plan to bring this reserve to a 70-day reserve by fiscal year 2013:

	<u>(Days of Operations)</u>
FY 2009 – \$27.2 million	(55)
FY 2010 – \$31.9 million	(60)
FY 2011 – \$36.8 million	(65)
FY 2012 – \$38.1 million	(70)
FY 2013 – \$40.0 million	(70)

**Capital Reserve**

This reserve is budgeted annually at \$5.0 million in the Capital Improvements Budget (CIP). The reserve is intended for unanticipated capital needs. Use of these funds for a CIP project other than the original project designation (project transfer) requires City Council action.

**Rate Stabilization Reserve**

Historically, this reserve is an unbudgeted amount. It is proposed that this policy will serve to keep a stable balance of \$20.5 million in this reserve in order to mitigate future rate increases. Deposits into the reserve are made from current system revenues. Use of the funds is to be limited only for the operation and maintenance of the water system.

The utilization of this Reserve during the course of the fiscal year does not require City Council action but may be used based upon the recommendation of the Department and approval of the Chief Financial Officer.

**Secondary Purchase Reserve**

Historically, this reserve is an unbudgeted amount. The proposed policy calls for the size of the reserve to equal 6% of the annual water purchase budget. The reserve may be funded by any lawful source. Withdrawal from the reserves will be necessary for the purchase of water should a major drought or emergency occur that diminishes the City's normal supply. The City Council action is required in order to appropriate these reserves into a program.

**Dedicated Reserve from Efficiency and Savings (DRES)**

Beginning in fiscal year 2008, two reserves, one for the Water Fund and one for the Metropolitan Wastewater Fund (which is currently in place), will be used to protect and preserve savings found by increasing efficiencies, changing priorities or other actions related to reducing costs of the Capital Improvements Program (CIP) or operations and maintenance of either system. The DRES will track funds that can be used for accelerating CIP project schedules and will help offset the need for any future rate increases. At the end of each fiscal year, any savings not required for compliance with established reserve policies will be transferred into this reserve. At the end of four years, any funds transferred into this reserve and not used for capital improvements will be used to lower future rates for the water and wastewater systems.

**WASTEWATER ENTERPRISE FUND RESERVE POLICY**

**Appropriated Reserve**

The Appropriated Reserve is budgeted annually for unanticipated expenditures. It may be used to fund either operating or capital needs. If this reserve is used to cover unanticipated operating expenses, the Department Director’s approval is required; however, if used for unanticipated capital needs, City Council action is required.

Current reserve levels are budgeted at \$3.3 million with intent to keep the reserve balance at the same level for future years based on historical requirements. An annual review of this level should be undertaken to determine adequate funding levels.

**Operating Reserve**

This reserve is intended to be used in the event of a catastrophe that prevents the utility from operating in its normal course of business. This Reserve is calculated based on the annual operating budget for the fiscal year. The Fiscal Year 2008 Budget for this reserve includes approximately \$31.6 million. The schedule below provides the proposed reserve balances for upcoming fiscal years with the plan to bring this reserve to a 70-day reserve by fiscal year 2013:

	<b><u>(Days of Operations)</u></b>
FY 2009 – \$31.6 million	(50)
FY 2010 – \$31.7 million	(50)
FY 2011 – \$35.9 million	(55)
FY 2012 – \$40.1 million	(60)
FY 2013 – \$48.1 million	(70)

**Capital Reserve**

The CIP Reserve is budgeted as a separate CIP Reserve at a level of \$5.0 million. Use of this reserve may only be used for capital costs. The City Council action is required for any withdrawal from the reserve.

**Rate Stabilization Fund**

This reserve is identical in rationale with the Rate Stabilization for the Water Fund: a source of funds used to mitigate future rate increases. It is expected that this reserve will reach \$13.3 million in fiscal year 2008. This reserve will be maintained at a level of 20% of system revenues less operating and non-operating expenses. The following are projected dollar targets to be achieved each year and will be adjusted based on 20% of actual revenues (less operating and non-operating expenses):

FY 2009 — \$19.3 million
FY 2010 — \$20.3 million
FY 2011 and beyond — maintain \$20.3 million

The utilization of this reserve during the course of the fiscal year does not require City Council action but may be used based upon the recommendation of the Department and approval of the Chief Financial Officer.

**Dedicated Reserve from Efficiency and Savings (DRES)**

Beginning in fiscal year 2008, two reserves, one for the Water Fund and one for the Metropolitan Wastewater Fund (which is currently in place), will be used to protect and preserve savings found by increasing efficiencies, changing priorities or other actions related to reducing costs of the Capital Improvements Program (CIP) or operations and maintenance of either system. The DRES will track funds that can be used for accelerating CIP project schedules and will help offset the need for any future rate increases. At the end of each fiscal year, any savings not required for compliance with established reserve policies will be transferred into this reserve. At the end of four years, any funds transferred into this reserve and not used for capital improvements will be used to lower future rates for the water and wastewater systems.

**AUTHORITY****Fiscal Reserve Policy**

It is recommended that as a matter of policy, any changes, additions, deletions to the Fiscal Reserve Policy must be brought forward to the Budget and Finance Committee for review followed by a presentation to the City Council for formal action.

Quarterly status reports will be provided to the Budget and Finance Committee and the City Council. In addition, any requests for the use of reserves will be accompanied by current status report of the affected reserve fund.

**Deviations from the Policy**

No deviations from the Fiscal Reserve Policy will be allowed except as recommended by the Mayor or the City Council, and approved by the City Council. This would include increasing or decreasing the basis of emergency reserves, expenditures from reserves for anything other than the intended use of said reserve, and expenditures from any fund balances above the stated basis of the emergency reserves. If one is requested, it must be first presented to the Chief Financial Officer for review of the fiscal impact and to determine its appropriateness.

The Chief Financial Officer will then bring the request to the Chief Operating Officer and the Mayor with a recommendation followed by a presentation to the Budget and Finance Committee. After the Budget and Finance Committee review, the item will be presented to the City Council for action.

**Reserve Expenditures**

Unless specified above, the authority to make expenditures from all reserves for all funds shall lie with the Mayor and City Council. Either the Mayor or the City Council may make recommendations for expenditures either through the budget process for dedicated or replacement reserves, or in the case of emergency or appropriated reserve expenditures, at regular or special City Council meetings.

**Replenishment of Reserves**

Should a particular reserve fall below the anticipated reserve level as stated in this Policy, the Mayor will bring forward a plan as part of the subsequent fiscal year budget to the Budget and Finance Committee and ultimately the City Council to replenish said reserve in a reasonable timeframe.

**EFFECTIVE DATE**

The Reserve Policy shall be effective upon Council Approval.

**CONCLUSION**

The fiscal impact of this policy is to provide for adequate cash balances to ensure that the City meets its cash flow obligations, maximizes earnings on investments, minimizes borrowing costs and maintains the highest credit rating on its bonds.

The Reserve Policy shall serve as a cornerstone for other budgetary and financial decisions. The Policy should be reviewed and discussed no less frequent than every two years. This review would examine the effectiveness of the current policy and would make recommendations for any modifications which may be prudent. This will ensure that the policy remains current with general accounting and finance best practices as well as any regulatory or standards changes that may emerge over time.

The key factor of the reserve policy is to develop the fiscal disciplines that should be strictly followed. Sound fiscal management practices will be required to ensure that reserves are maintained and properly used.

Respectfully submitted,



Jay M. Goldstone  
Chief Operating Officer

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CC: Honorable Mayor Jerry Sanders  
Members of the City Council  
Mary Lewis, Financial Management Director  
Andrea Tevlin, Independent Budget Analyst  
Greg Levin, City Comptroller

## Dedicated Reserve from Efficiencies and Savings

### Purpose:

The City will establish a means to identify, track and secure year-to-year budget savings that occur in the Water and Wastewater Departments (Funds). These savings will be specifically identified in the City's general ledger and can be audited. This policy will remain in effect for a period no less than the duration of the fiscal year 2007 four-year rate case. The savings will be used for water and wastewater capital projects, respectively or to minimize future rate increases.

### A. The Establishment of Dedicated Reserves:

1. The City will establish a Reserve Account within the respective Water and Wastewater Funds entitled "Dedicated Reserves from Efficiencies and Savings" (Reserve).
2. A semi-annual report will be issued to the Independent Rates Oversight Committee (IROC) which identifies any transfers to or from this Reserve during the prior.
3. At the end of each fiscal year, any savings not required to comply with established policies or legal documents will be transferred into the Reserve.
4. At the end of the four years, any funds transferred into this Reserve and not used for capital improvements will be used to lower future rates.
5. Nothing in this policy will interfere in any way with any contractual or legal obligations entered into by the Departments, including but not limited to any rate covenants in any bond indenture.

### B. Capital Improvements (CIP):

1. CIP projects to be funded as part of the rate case will be monitored on a project by project basis.
2. At the point in time when the construction contract is awarded, should the projected project cost be larger than anticipated, the budget will be amended and a funding source identified. To the extent there are funds in the Reserve, the funding will be transferred from the Reserve.
3. Quarterly, a project savings report will be prepared and presented to the IROC. Any savings identified will be transferred to the Reserve.

### C. Operations and Maintenance (O&M):

1. The operations and maintenance budgets as presented in the 2007-08 budget case will be monitored on a line item basis and financial results will be reported to the IROC on a quarterly basis.

At the end of the fiscal year, any O&M savings will be transferred to the Reserve.

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**Estimated General Fund Working Capital (Unaudited)**

2007 Ending Cash or Equity in Pooled Cash and Investments	\$ 95,817,310
Receivables (Due Within 60 Days)	63,832,530
Payables	<u>(33,687,584)</u>
Working Capital Beginning Balance	125,962,257
Encumbrances	(34,029,552)
Other Restrictions	<u>(1,150,857)</u>
	(35,180,410)
Total Working Capital at 07-01-07	<u>90,781,847</u>
Actions Taken Since 7-1-07 (Macias, Gini & O'Connell, LLP)	(688,000)
Amounts Encumbered Waiting for Action (Charger's Settlement)	(1,980,340)
New Action (Hawkins Delafield & Wood)	(369,500)
New Action (Appropriate Reserve)	(7,000,000)
<b>Total Working Capital</b>	<b><u>80,744,007</u></b>

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**REQUEST FOR COUNCIL ACTION**  
CITY OF SAN DIEGO

1. CERTIFICATE NUMBER  
(FOR AUDITOR'S USE ONLY) 200  
10/22

TO: City Attorney  
2. FROM (ORIGINATING DEPARTMENT): Financial Management- Department of Finance  
3. DATE: 10/12/2007

4. SUBJECT:  
City Reserve Policy

5. PRIMARY CONTACT (NAME, PHONE & MAIL STA.)  
Mary Lewis/235-5880 MS 8A

6. SECONDARY CONTACT (NAME, PHONE & MAIL STA.)  
Irina Kumits/235-5714 MS 8A

7. CHECK BOX IF REPORT TO  
COUNCIL IS ATTACHED

**8. COMPLETE FOR ACCOUNTING PURPOSES**

FUND	100				9. ADDITIONAL INFORMATION / ESTIMATED COST: General Fund unallocated reserve will be reduced by \$7,000,000. See attached for further details.
DEPT.	602				
ORGANIZATION					
OBJECT ACCOUNT	9944				
JOB ORDER					
C.I.P. NUMBER					
AMOUNT	7,000,000				

**10. ROUTING AND APPROVALS**

ROUTE (#)	APPROVING AUTHORITY	APPROVAL SIGNATURE	DATE SIGNED	ROUTE (#)	APPROVING AUTHORITY	APPROVAL SIGNATURE	DATE SIGNED
1	ORIGINATING DEPARTMENT (MARY LEWIS)	Mary Lewis	10/12/07	8	ORIGINATING DEPT (MARY LEWIS)	Mary Lewis	10/12/07
2	EAS			9			
3	EOCP			10			
4	LIAISON OFFICE			11			
5	AUDITOR		10/12/07	DOCKET COORD: _____ COUNCIL LIAISON: _____			
6	COO (JAY M. GOLDSTONE)		10/12/07	COUNCIL PRESIDENT <input type="checkbox"/> SPOB <input type="checkbox"/> CONSENT <input type="checkbox"/> ADOPTION			
7	CITY ATTORNEY (MARK D. BLAKE)			REFER TO: _____ COUNCIL DATE: _____			

11. PREPARATION OF:  RESOLUTION(S)  ORDINANCE(S)  AGREEMENT(S)  DEED(S)

- Approve City Reserve Policy.
- Establish the Appropriated Reserve Department, Fund 100, Dept 602, and appropriate \$7,000,000 from the General Fund Unallocated Reserve to Fund 100, Department 602, to establish an Appropriated Reserve.

11A. STAFF RECOMMENDATIONS:

Staff recommends the approval of the resolution.

12. SPECIAL CONDITIONS:

COUNCIL DISTRICT(S): ALL

COMMUNITY AREA(S): N/A

ENVIRONMENTAL IMPACT: THIS ACTIVITY IS NOT A "PROJECT" AND IS THEREFORE NOT SUBJECT TO CEQA PURSUANT TO STATE CEQA GUIDELINES SECTION 05060 (C) (3).

HOUSING IMPACT: N/A

OTHER ISSUES: N/A

ORDINANCE NUMBER O-\_\_\_\_\_ (NEW SERIES)

DATE OF FINAL PASSAGE \_\_\_\_\_

AN ORDINANCE APPROVING THE CITY OF SAN DIEGO'S RESERVE POLICY AND AMENDING ORDINANCE NO. O-19652 ENTITLED "AN ORDINANCE ADOPTING THE ANNUAL BUDGET FOR THE FISCAL YEAR 2007-2008 AND APPROPRIATING THE NECESSARY MONEY TO OPERATE THE CITY OF SAN DIEGO FOR SAID FISCAL YEAR," AND AUTHORIZING AND DIRECTING THE AUDITOR AND COMTROLLER TO ESTABLISH AN APPROPRIATED RESERVE (DEPARTMENT 602) IN THE GENERAL FUND AND TRANSFERRING AND APPROPRIATING \$7,000,000 FROM THE GENERAL FUND UNALLOCATED RESERVE TO DEPARTMENT 602 TO ESTABLISH AN APPROPRIATED RESERVE FOR FISCAL YEAR 2008

WHEREAS, on July 30, 2007, the City Council adopted Ordinance No. O-19652 [Annual Appropriation Ordinance] to provide for the appropriation and expenditure of funds for the Fiscal Year 2007-2008; and

WHEREAS, on the date hereof the Mayor has presented a City Reserve Policy to ensure that the City establishes and maintains prudent reserves, and said report is attached hereto as Exhibit A; and

WHEREAS, the Mayor has recommended that a General Fund Appropriated Reserve be established and funded for unanticipated budgetary needs in Fiscal Year 2008 with an appropriation of \$7,000,000 from the General Fund Unallocated Reserve; NOW, THEREFORE,

BE IT ORDAINED by the Council of the City of San Diego, as follows:

1. All of the foregoing recitals are true and correct, and the City Council so finds and determines.
2. The City Reserve Policy is hereby accepted and approved.

3. The Auditor and Comptroller is hereby authorized and directed to establish the Appropriated Reserve Department 602 in the General Fund.

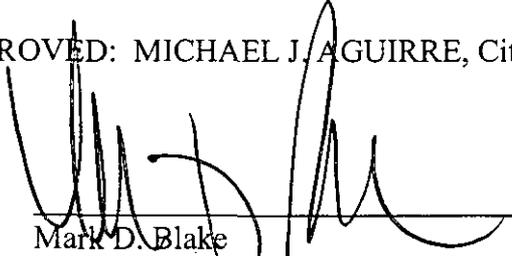
4. The Auditor and Comptroller is hereby authorized and directed to transfer \$7,000,000 from the General Fund Unallocated Reserve to Department 602 for deposit in the General Fund Appropriated Reserve for Fiscal Year 2008.

5. A full reading of this Ordinance is dispensed with prior to its final passage, a written or printed copy having been available to the City Council and the public a day prior to its final passage.

6. This ordinance is declared to take effect and be in force immediately upon its passage after two (2) public hearings pursuant to the authority contained in Section 71, 275, and 295 of the Charter of the City of San Diego.

APPROVED: MICHAEL J. AGUIRRE, City Attorney

By

  
Mark D. Blake  
Chief Deputy City Attorney

MDB:jdf  
10/17/07  
Or.Dept:FM  
O-2008-55

I hereby certify that the foregoing Ordinance was passed by the Council of the City of San Diego, at this meeting of \_\_\_\_\_.

ELIZABETH S. MALAND  
City Clerk

By \_\_\_\_\_  
Deputy City Clerk

Approved: \_\_\_\_\_  
(date)

\_\_\_\_\_  
JERRY SANDERS, Mayor

Vetoed: \_\_\_\_\_  
(date)

\_\_\_\_\_  
JERRY SANDERS, Mayor

000237

The City of San Diego  
CERTIFICATE OF CITY AUDITOR AND COMPTROLLER

CERTIFICATE OF UNALLOTTED BALANCE

AC 2800288

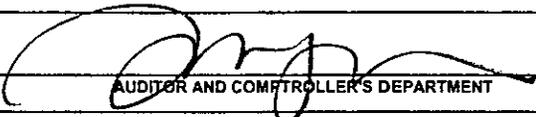
ORIGINATING

DEPT. NO.: 055

I HEREBY CERTIFY that the money required for the allotment of funds for the purpose set forth in the foregoing resolution is available in the Treasury, or is anticipated to come into the Treasury, and is otherwise unallotted.

Amount: \$7,000,000.00 Fund: 100

Purpose: To set up Appropriated Reserve within the General Fund.

Date: October 12, 2007 By: 

AUDITOR AND COMPTROLLER'S DEPARTMENT

ACCOUNTING DATA

ACCTG. LINE	CY PY	FUND	DEPT	ORG.	ACCOUNT	JOB ORDER	OPERATION ACCOUNT	BENF/ EQUIP	FACILITY	AMOUNT
001	0	100			9544					\$7,000,000.00
TOTAL AMOUNT										\$7,000,000.00

FUND OVERRIDE

CERTIFICATION OF UNENCUMBERED BALANCE

I HEREBY CERTIFY that the indebtedness and obligation to be incurred by the contract or agreement authorized by the hereto attached resolution, can be incurred without the violation of any of the provisions of the Charter of the City of San Diego; and I do hereby further certify, in conformity with the requirements of the Charter of the City of San Diego, that sufficient moneys have been appropriated for the purpose of said contract, that sufficient moneys to meet the obligations of said contract are actually in the Treasury, or are anticipated to come into the Treasury, to the credit of the appropriation from which the same are to be drawn, and that the said money now actually in the Treasury, together with the moneys anticipated to come into the Treasury, to the credit of said appropriation, are otherwise unencumbered.

Not to Exceed: \_\_\_\_\_

Vendor: \_\_\_\_\_

Purpose: \_\_\_\_\_

Date: \_\_\_\_\_ By: \_\_\_\_\_

AUDITOR AND COMPTROLLER'S DEPARTMENT

ACCOUNTING DATA

ACCTG. LINE	CY PY	FUND	DEPT	ORG.	ACCOUNT	JOB ORDER	OPERATION ACCOUNT	BENF/ EQUIP	FACILITY	AMOUNT
TOTAL AMOUNT										

FUND OVERRIDE

AC 2800288